

JAPAN CHAIR PLATFORM

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2013, Year of Japan's Revival? Abenomics and the Politics of Growth

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The new Shinzo Abe cabinet emerged from the holidays with a seemingly renewed sense of urgency in rebuilding Japan's long crippled economy. Prime Minister Abe's plans have been dubbed "Abenomics" (pronounced Ah-beh-nomics) by the popular press. What precisely does this term mean, and what are its implications for Japan in 2013 and beyond?

The content of Abenomics thus far centers on a few key economic policies believed to be critical in giving the Japanese economy a much needed boost. Its main goals are to end Japan's long-term deflation, to devalue the yen, and to achieve a nominal growth rate of roughly 3 percent. The main policies include, among others, a 2 percent inflation target, a rapid increase in public spending, and a renewed focus on increasing Japan's economic competitiveness. While foreign policy concerns continue to lurk in the background, Abe's early and repeated statements emphasizing key economic targets signifies that he has placed economic revitalization front and center in his second prime ministership.

Abe's short-term goal is electoral victory in the Upper House elections this summer. In fact, as early as a week before the Lower House elections in December, the Liberal Democratic Party (LDP) already began to shift its focus toward the Upper House elections, signaling how critical it is for them to have control over both houses. Indeed, Japan's Upper House has been considered by electoral scholars to be too strong and has been accused of hampering past efforts to pass much needed reforms. For example, the president of the Upper House has the authority to decide what bills to bring before the chamber for a vote, thereby greatly affecting the process of legislative deliberations in the Diet. To gain complete political control over the legislative process, the LDP needs to win a majority of seats.

To ensure electoral victory in the Upper House, Abe and the LDP need to demonstrate their clear commitment to economic revitalization. Furthermore, some immediate signs of economic recovery will be critical for maintaining the momentum gained from the strong electoral showing in December. In the first weeks of the New Year, Abe and his new cabinet have made such indications in several ways. First, Abe has resurrected the Council on Economic and Fiscal Policy. The 11-member council, which includes economic ministers, business leaders, and academics, is in charge of compiling broad medium- to long-term economic and fiscal policy. This council was used deftly by former prime minister Junichiro Koizumi to orchestrate "decisive politics," and Abe hopes to use it in a similar manner, placing control of Japan's economic rudder in the prime minister's office. The council will also play a key role in communications between the government and the Bank of Japan (BOJ) because the BOJ governor is one of its sitting members.

Second, Abe created a new governance body for microeconomic policy, the Economic Revitalization Headquarters, which includes all cabinet ministers with decisionmaking power consolidated under Abe. Its main concern will be to outline the government's emergency stimulus package. The central government will compile a 13.1 trillion yen supplementary budget for fiscal year 2012 ending in March to finance the package, with 10.3 trillion yen of this to be specifically used for fresh stimulus spending. The stimulus plan includes accelerated reconstruction of the Tohoku region, strengthened disaster prevention measures, and fiscal policies to combat the nation's prolonged deflation and overvalued yen.

Lastly, Abe also launched a new panel under the economic revitalization headquarters called the industrial competitiveness council to draw up concrete growth strategies. Koizumi's economic and fiscal policy minister, Heizo Takenaka, is one of nine private-sector members. The panel also includes select cabinet ministers and leaders from Japan's most vibrant corporations including Rakuten CEO Hiroshi Mikitani and Lawson CEO Takeshi Niinami, creating further hope for dynamic change. The government plans to formulate its new growth strategy by June, focusing on industrial resuscitation, overseas expansion by Japanese companies, and the creation of new markets.

Combined, these three organizations will help plan Japan's economic recovery, but there is already some concern as to how Abe will coordinate these many councils. The Fiscal Council and the Economic Revitalization Headquarters are the

administration's two main economic wheels; however, the Fiscal Council remains in the Cabinet Office, while the Economic Revitalization Headquarters has been placed in the Cabinet Secretariat.

As for signs of recovery, the LDP's clear victory in the December Lower House elections gave Japan's business world high hopes, and already we see some indicators of positive change. The long overvalued Japanese yen has lost nearly 10 percent of its value in just a few short weeks, hovering around 88 Japanese yen to the dollar. The yen is still too expensive for many of Japan's exporters to sit back and relax, but the direction of change has invited warm enthusiasm. The benchmark Nikkei 225 stock average reached a 22-month high at the end of the first trading session of the year, closing at 10,688.11, and it has climbed nearly 23 percent since mid-November when former prime minister Yoshihiko Noda dissolved the Lower House. Finally, even Japan's badly damaged energy sector sees brighter times ahead with shares of energy companies gaining as the LDP leans toward restarting nuclear plants.

Japan watchers and Japanese voters, however, should not get too carried away by these early signs of economic revival. The content of Abenomics has several worrisome elements. First and foremost is the large increase in debt being proposed to propel Japan out of its long-term deflationary spiral. Abe has submitted plans for a new economic stimulus package worth over 20 trillion yen, half of which will be covered by the central government. Abe also announced plans for the government to spend over 19 trillion yen for the reconstruction of areas devastated by the March 2011 earthquake over five years through fiscal 2015. While several prominent economists have argued for the need to inject a significant amount of public funds into the Japanese economy in order to yank it out of its deflationary state once and for all, the cost to Japan's future taxpayers will be unprecedented. As such, spending plans for these precious funds requires the utmost care, and voters must hold politicians and bureaucrats accountable for appropriately evaluating how this money is spent.

Second, a key component of the revitalization plan is the use of the BOJ to target a 2 percent inflation rate, but the division of responsibilities between the government and the BOJ remains unclear. Shortly after the LDP's electoral victory, Abe called BOJ governor Masaaki Shirakawa to sign an accord that would hold the BOJ accountable for monetary and fiscal policy by setting an inflation target. However, no deadline has been set (yet) for meeting this target, calling some to question Abe's own belief in Japan's ability to reach this target and portraying the BOJ as eager to shirk responsibility. Under Japan's zero interest-rate policy, the BOJ on its own has little room to raise the inflation rate. Currently, the only feasible way for Japan to effectively raise the inflation rate is through broad fiscal spending, and this is the responsibility of the government. As such, there should be a clear division of responsibility between the government and the BOJ, with the BOJ maintaining its zero interest-rate policy until set economic goals (such as reaching a target nominal GDP) are reached.

Lastly, the BOJ's past record has many outside observers skeptical of Abe's plans and his ability to use monetary policy effectively. During the last decade, the BOJ has tried a variety of monetary measures including quantitative easing in an attempt to break Japan's deflationary trends, but it has been criticized for being overly cautious and piecemeal in its efforts. By repeatedly stopping short of a massive expansion of its balance sheet, the BOJ has yet to fully buy into the Friedman school of monetary theory. Still, hope is in the air. Since the beginning of the year, Abe and his cabinet have signaled a stronger determination to persuade the BOJ to take a more aggressive and comprehensive approach, combining quantitative easing with fiscal stimulus to expand the BOJ's balance sheet. Abe also has an additional weapon in his ability to nominate the new governor of the BOJ in April. While the implementation of Abenomics will require a careful balancing act, this time Abe must go full throttle; too much caution can tip Japan over a monetary cliff.

According to the Chinese zodiac calendar, 2013 is the year of the snake, a creature that sheds its skin each year to emerge with a glossy new coat. Politicians and business leaders interviewed in the Japanese media have repeatedly used this image to illustrate their hopes for revitalizing Japan. Only an economically stronger Japan can be an effective ally for the United States, a valuable neighbor for China and the rest of Asia, and a source of pride for the Japanese people. As Nietzsche said, "the snake that cannot shed its skin perishes."

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